Value Based Marketing Systems and You, The Producer

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There is momentum in the cattle industry to move away from a marketing system that is based on the sale of a generic commodity and towards what have been termed value based marketing systems (VBMS). Industry leaders have suggested a target of selling half of the cattle produced in America in some type of VBMS by the year 2002.

Individual beef carcasses of similar weight can differ in value by as much as $150 to $300. In VBMS the producer is paid for the actual value of the individual carcasses produced by a pen of cattle as opposed to an average price based on the buyer's estimate of the carcass merit. Numerous factors affect these value differences among beef carcasses. The two primary factors are the USDA Quality and Yield grades. Quality grade is an estimate of the palatability or eating characteristics of the beef. Yield grade is an estimate of the percentage of trimmed, boneless retail cuts that a carcass would yield when it is fabricated. These two factors -- quality and yield -- comprise the basis for most pricing grids (see example on page 4).

Other factors can result in significant discounts in carcass price. Ideally, carcasses should weigh between 650 and 850 pounds; however, most packers currently accept carcasses from 550 to 950 pounds without discounts. Lighter weight carcasses are discounted because they are inefficient to process, and heavier weight carcasses are discounted because they create portion size concerns as well as fabrication problems when processing boxed beef. Dark cutters, bullocks, and hardbone carcasses also are severely discounted. Dark cutters have very dark colored lean and are very difficult to merchandise in the retail case. Bullocks, or stags, have been associated with less tender beef. Hardbone carcasses occur when cattle purchased as young cattle have older bone maturity and cannot qualify for the young cattle quality grades or Prime, Choice, Select, and Standard. The severe discounts for light and heavy weight carcasses, dark cutters, hardbone, and bullock carcasses make it very important to design management strategies to avoid these "outlier" cattle if you are marketing on a VBMS.

VBMS take many forms. They are being offered by packers, breed associations, and many different alliances in an attempt to provide the consumer with a uniform beef product that has predictable eating qualities. Through a system of carcass premiums and discounts, a producer is sent signals though the marketplace to reward or penalize the production of various types of cattle. While one VBMS may encourage longer feeding periods through premiums for cattle with higher marbling scores, another may discourage additional days on feed by rewarding cattle that are higher in cutability and lean yield.

By design, VBMS impose restrictions on the type and kind of cattle that they allow into their programs. The financial risk associated with participation in a VBMS may or may not be greater than the risk associated with other marketing methods.
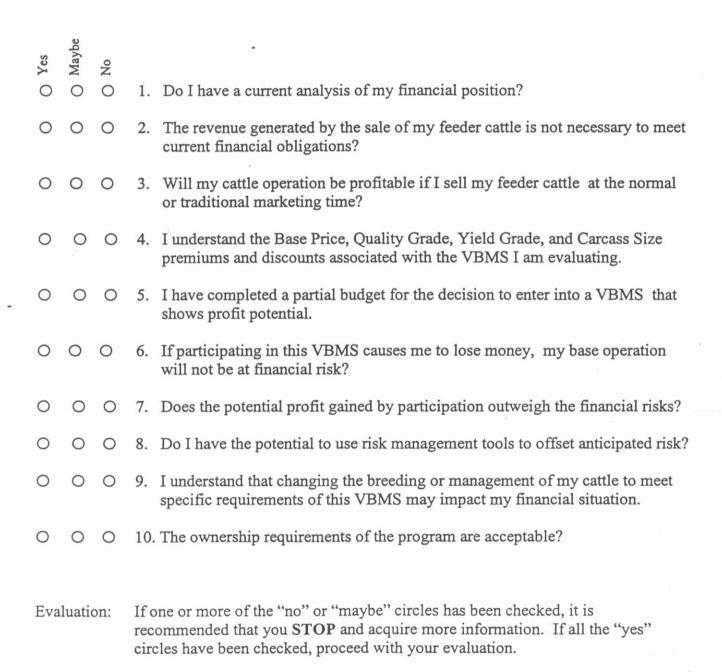
Complete the following worksheets to help you determine if your cattle and the VBMS you are evaluating are a good fit. The worksheets can also help you determine if the risk of participating is offset by financial gain.

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Value Based Marketing: Can I Handle the Financial Risk?

The following exercise is designed to help you make an informed decision about your ability to handle the risk associated with extending ownership and participating in a VBMS with a selected group of your feeder cattle.

Yes	Maybe	No		
O	O	O	1.	Do I have a current analysis of my financial position?
O	O	O	2.	The revenue generated by the sale of my feeder cattle is not necessary to meet current financial obligations?
O	O	O	3.	Will my cattle operation be profitable if I sell my feeder cattle at the normal or traditional marketing time?
O	O	O	4.	I understand the Base Price, Quality Grade, Yield Grade, and Carcass Size premiums and discounts associated with the VBMS I am evaluating.
O	O	O	5.	I have completed a partial budget for the decision to enter into a VBMS that shows profit potential.
O	O	O	6.	If participating in this VBMS causes me to lose money, my base operation will not be at financial risk?
O	O	O	7.	Does the potential profit gained by participation outweigh the financial risks?
O	O	O	8.	Do I have the potential to use risk management tools to offset anticipated risk?
O	O	O	9.	I understand that changing the breeding or management of my cattle to meet specific requirements of this VBMS may impact my financial situation.
O	O	O	10.	The ownership requirements of the program are acceptable?

Evaluation: If one or more of the "no" or "maybe" circles has been checked, it is recommended that you **STOP** and acquire more information. If all the "yes" circles have been checked, proceed with your evaluation.

Value Based Marketing: Do My Cattle Fit?

Answering the following questions may help determine if the VBMS you are evaluating is a good fit with your beef production system.

	Yes	Maybe	No	
1.	○	○	○	My breeding program fits the requirements of the program I am evaluating.
2.	○	○	○	I have historical carcass data on my cattle.
3.	○	○	○	My cattle produce carcasses that fit the requirements of the program.
4.	○	○	○	I have historical feedlot performance data on my cattle.
5.	○	○	○	My cattle's historic feedlot performance indicates they can meet the requirements of the program.
6.	○	○	○	My health program matches or can be adapted to the requirements of the program.
7.	○	○	○	I can meet the specific feedlot or delivery requirements of the program.

Evaluation: If one or more of the "no" circles has been checked, your cattle probably will not fit the program you are evaluating and may cost you money or not return the expected income. Checked "maybe" circles indicate areas where more information may be needed. If all the "yes" circles have been checked, the program you are evaluating looks like a good fit.

Financial Evaluation Worksheet
(Make these calculations on a per head basis.)

Projected Income

a.   Market Value   _____

b.   +/- Carcass
     Premium/Discount
     (see worksheet)   _____

Cost Savings

c.   Marketing   _____

d.   Transportation   _____

e.   Management   _____
     (e.g. VBMS may restrict
     use of certain products)

Total Revenue   _____

Projected Expenses

a.   Feeder Value   _____

b.   Feed   _____

c.   Yardage   _____

d.   Financing   _____

e.   Veterinary   _____

f.   Death Loss   _____

g.   Transportation   _____

h.   Entry Fees   _____

I.   Performance Limitations   _____
     (e.g. Not using an implant
     reduces final weight.)

Total Expenses   _____

Net Income = Total Revenue - Total Expenses   _____

Pricing Grid Worksheet.
Follow the example when using your own numbers to fill in the blank worksheet below.

Pricing Grid Worksheet. Fill in the premium/discounts (P/D) for the VBMS you are evaluating and your estimate of the % of your cattle that fall into each cell.

	YG1 P/D	YG1 %	YG2 P/D	YG2 %	YG3 P/D	YG3 %	YG4 P/D	YG4 %	YG5 P/D	YG5 %
	P/D	%	P/D	%	P/D	%	P/D	%	P/D	%
Prime	11 x 0 = 0		10 x .01 = .10		8 x .02 = .16		(4) x 0 = 0		(10) x 0 = 0	
CAB	6 x 0 = 0		5 x .02 = .10		3 x .21 = .63		(9) x .01 = (.09)		(15) x 0 = 0	
Choice	3 x 0 = 0		2 x .11 = .22		50% Ch YG3 Base Price		(12) x .02 = (.24)		(18) x 0 = 0	
Select	(5) x 0 = 0		(6) x .04 = (.24)		(8) x .06 = (.48)		(20) x 0 = 0		(26) x 0 = 0	
Standard	(22) x 0 = 0		(23) x 0 = 0		(25) x 0 = 0		(37) x 0 = 0		(43) x 0 = 0	
Total Each Column	(A) sub-total = 0		(B) sub-total = .18		(C) sub-total = .31		(D) sub-total = (.33)		(E) sub-total = 0.16	

TOTAL PREMIUM/(DISCOUNT) (A + B + C + D + E) $ Per Cwt = __0.16__

$/cwt Premium/Discount x Avg cwt/carcass = Total Premium (Discount)/head = _____

Additional Discounts to consider: Dark Cutters (30)
Carcass Wt < 550 lb (10); > 950 lb (15)
Stags, Heiferettes, Utility (30)

Pricing Grid Worksheet. Fill in the premium/discounts (P/D) for the VBMS you are evaluating and your estimate of the % of your cattle that fall into each cell.

	YG1 P/D	YG1 %	YG2 P/D	YG2 %	YG3 P/D	YG3 %	YG4 P/D	YG4 %	YG5 P/D	YG5 %
	P/D	%	P/D	%	P/D	%	P/D	%	P/D	%
Prime	__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __	
CAB	__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __	
Choice	__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __	
Select	__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __	
Standard	__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __		__ x __ = __	
Total Each Column	(A) sub-total = __		(B) sub-total = __		(C) sub-total = __		(D) sub-total = __		(E) sub-total = __	

TOTAL PREMIUM/(DISCOUNT) (A + B + C + D + E) $ Per Cwt = _____

$ Premium/Discount x Avg cwt/carcass = Total Premium (Discount)/head = _____

Additional Discounts to consider: Dark Cutters (_____)
Carcass Wt < _____ lb (_____); > _____ lb (_____)
Stags, Heiferettes, Utility (_____)